

The Opportunity in SaaS

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I personally find the SaaS software industry very interesting because of the high level of innovation. There's been an increasing number of SaaS companies that have come to market over the last 10-15 years and the level of innovation that's happening in this market is truly astounding as well as the transformation in the associated business models. We at Alger are focused on innovative companies that use differentiated and disruptive technologies to create value for their customers.

The software industry is an area of focus at Alger. It is undergoing a multi-year secular shift towards cloud computing and software as a service model or SaaS. We believe this shift is capable of producing sustained revenue growth for many years to come. We at Alger specialize in evaluating these businesses and employ a rigorous bottoms-up approach that enables us to uncover attractive investment opportunities for our clients.

SaaS is a software delivery and licensing model in which the software application is: 1) centrally hosted and managed by the vendor, 2) is deployed over a network to the end user, and 3) the customer licenses the right to use the software through a subscription fee which can be scaled up or down on an as needed basis.

The advantages for customers include lower initial costs and flexible pay as you go pricing, often greater functionality with more frequent upgrades, and freedom from having to manage the infrastructure to run the



applications. The advantages for the companies include increased financial visibility because their revenue base is comprised of recurring subscription fees as well as potentially high incremental margins if customers are happy and renewal rates are high.

We search for SaaS companies that exhibit 4 key characteristics: 1) they serve large total addressable markets, 2) they have differentiated and disruptive technologies, 3) they have sustainable competitive moats, and 4) they have efficient go to market models with compelling unit economics.

Thematically, we seek out companies that automate and streamline manual business processes, companies with unique data advantages that can turn data into actionable intelligence, in addition companies that have large ecosystems which can sometimes increase the functionality of the company's solutions and be a good source for referrals and customer additions.

At Alger, we also study the underlying unit economics of a company and evaluate metrics such as cost of customer acquisition, retention rates, and sales and marketing efficiency.

Overall, we believe SaaS companies that demonstrate superior unit economics warrant higher valuations and we endeavor to identify these companies early on in their life cycles.

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